

JESA INVESTMENT & MANAGEMENT CO. LTD.

NEWSLETTER

JANUARY 2012

In this issue:

- **News from Jesa: “Delocalization vs. Commercialization”**
- **Retail in China: sector analysis**
- **New Social Security Law: Beijing started the implementation**

NEWS FROM JESA: "Delocalization vs. Commercialization"

By Saro Capozzoli, Founder of JESA Investment Ltd

In the last months we have been receiving some requests of support in delocalization operations in China from companies that want to close their plant in Italy and open in China instead, in order to take advantage of the relatively low production costs and keep on selling in their traditional markets: Italy and Europe.

Jesa doesn't agree on this kind of approach due to the following reasons:

1. The closing of the plant in Italy contributes to the increase of the already high unemployment rate of our Country. The companies are in this way losing their social function and shifting to a model that only aims to minimize the costs and maximize the profit. However, such a model can turn against the company, creating a bad image and leading to the loss of local expertise;
2. The cost advantages of productive delocalization are now quite limited. The times when delocalization of the production meant halve the production costs are already over;
3. The delocalization process is more complex and requires bigger financial resources;

4. This kind of approach is shortsighted because it doesn't consider the opportunities offered by emerging markets in terms of domestic consumption;

5. There is no more time to build up a complex structure in China. However, Italian enterprises still can catch the commercial opportunities offered by the new policies launched by the Chinese government with the aim of promoting domestic consumption and decreasing their dependence on exports;

6. The increase of Chinese average salaries together with the changes in consumption trend, especially among the new generations, are pushing towards a greater demand for quality products.

Therefore, Jesa suggests to focus on commercialization of our products in Chinese market, in order to satisfy the growing demand for quality from Chinese consumers.

The commercialization can take place through the direct presence with shops, marketing and sales structures, and others, in order to have a complete control over price and advertisement policies, monitoring agents and distributors and so on.

The opening of a shop is itself an important promotional tool. One only needs to think of how many people per day can pass by in front of a shop in a

Chinese town. In Shanghai, for example, there are roads where every day pass more than 1 million people.

Last week I was with a group of Chinese friends in Verona and walking in the main street I noticed that they were attracted by a shop among the many present in the street. They entered and purchased Jewelry for more than 100k Euro in less than 1 hour. Why this? That brand is present in China with few shops, so it become familiar to them and they based their purchase decision on the brand awareness and no other reasons. This is just an example of how it is important to be present in China if we want to sell more even in Italy.

In the following article we have analyzed in details the retail industry in China.

Enjoy the read!

* * * ITALIAN VERSION * * *

Negli ultimi mesi ci sono arrivate richieste di supporto per processi di delocalizzazione in Cina da parte di aziende intenzionate a chiudere i propri stabilimenti in Italia e aprire in Cina per sfruttare i relativamente bassi costi di produzione con il fine di continuare a vendere nei tradizionali mercati di riferimento: Italia ed Europa.

Noi di Jesa siamo contrari a questo tipo di approccio per i seguenti motivi:

1. La chiusura dei propri impianti nel territorio italiano va ad alimentare il tasso di disoccupazione già cronico nel nostro Paese, con la perdita della funzione sociale che era propria dell'azienda, a favore di una politica improntata alla minor spesa e al maggior profitto possibile. Una politica del genere non potrà fare altro che ritorcersi contro alla azienda stessa, attraverso un cattivo ritorno di immagine e la perdita dell'expertise locale;
2. I vantaggi a livello di costo della delocalizzazione produttiva sono ormai limitati. Sono ormai passati i tempi in cui delocalizzare la propria produzione in Cina significava dimezzare i propri costi;
3. Il processo di delocalizzazione è più complesso e richiede ingenti risorse finanziarie;
4. Questo approccio è indice di una visione miope delle possibilità che i mercati emergenti possono offrire a livello di consumo interno;
5. Non c'è più tempo per strutturarsi in Cina, ma le imprese italiane possono aggrapparsi alle opportunità commerciali offerte dalle politiche governative che promuovono con forza il consumo interno, nel tentativo di diminuire la propria dipendenza dalle esportazioni.

6. La media dei salari in Cina è in aumento e il cambiamento dei trend di consumo, soprattutto negli strati più giovani della popolazione, ha fatto crescere la domanda di prodotti di qualità.

Noi di Jesa consigliamo, dunque, di puntare alla commercializzazione nel mercato cinese dei nostri prodotti, per rispondere alla crescente domanda di qualità da parte dei consumatori cinesi.

La commercializzazione può avvenire attraverso una presenza diretta con negozi propri o strutture di marketing e vendita, in modo da poter avere il controllo totale per quanto riguarda politiche di prezzo e di comunicazione, monitorare l'operato degli agenti e dei distributori, ecc.

L'apertura stessa di un negozio può diventare uno strumento importante di promozione dei propri prodotti. Basti pensare a quante persone qua in Cina passano davanti alle vetrine di un negozio ogni giorno. A Shanghai, per esempio, ci sono strade in cui ogni giorno passano più di 1 milione di persone.

La scorsa settimana ero a Verona con un gruppo di amici cinesi e passeggiando per la via principale mi sono accorto che erano stati attratti da un negozio in particolare tra i tanti presenti nella strada. Sono entrati e hanno comprato gioielli per più di 100 mila Euro in meno di un'ora. Perché? Quel marchio è presente in Cina attraverso alcuni negozi, quindi è

diventato noto tra i cinesi, che hanno quindi basato la loro decisione di acquisto esclusivamente sulla conoscenza del marchio. Questo è solo un esempio di quanto sia importante essere presenti in Cina se si vuole vendere di più anche in Italia.

Nell'articolo successivo, verranno esaminate in dettaglio le opportunità nel settore retail cinese.

Buona lettura!

Retail in China: sector analysis

Overview on Chinese retail industry

China is the world's fastest-growing major retail market.

According to the Global Retail Development Index, China placed 6th in 2011.

China's retail market size is USD 2.1 trillion with a growth rate of 15% between 2009 and 2010.

According to the latest report issued by China Chain Store and Franchise Association (CCFA), the total sales volume of the top 100 chain retailers reached 1.66 trillion RMB in 2010 and registered an increase

of 21.2% compared to 2009. The number of stores of the top 100 chain retailers amounted to

150,000, with an year-on-year increase of 9.8%.

New consumption trends

Although many consumers are worried about increased inflation, Chinese consumers still remain positive about their income levels and future expectations on their employment situation, thanks also to the latest five-year plan, which pushes toward domestic consumption. As a consequence, the consumer spending is expected to increase by USD 100 billion per year.

There are also significant changes in the consumption behavior: while high-end consumers are promoting the development of high-end department stores, supermarket and shops in general, the increased living cost and the maturation of Chinese consumers both in urban and rural areas lead them to focus more on product quality and become more and more aware of their rights. The good quality and some customer care service are now the key drivers for the purchasing.

New opportunities in third- and fourth- tier cities

According to CCFA's *Report on Retail Outlet Distribution Feature in Urban Areas* that covers Beijing, Chongqing and Taiyuan, the number of retail outlets is close to its saturation point in the first-

and second-tier cities, as niche market is experiencing further segmentation. However, there are still space for potential expansion in first- and second-tier cities. At the same time, markets in third- and fourth-tier cities are becoming mature, offering new development opportunities. Many chain retailers based in those cities achieved remarkable results. The main aim is to obtain the first-mover advantage. However, a preliminary analysis on the local market situation has to be done, in order to investigate the actual expenditure capability in these areas and avoid to invest too early, when the market is not ready yet and too poor.

Diversification of retail format

Retail formats are diversifying, with an increased importance of specialty stores, in particular in the sectors of cosmetics and wine. Consumers now prefer to buy in this kind of stores rather than in supermarket and department stores because specialized stores offer a broader price range and product selection.

Online shopping is increasing dramatically and is driven primarily by young consumers in more developed regions and increased Internet access. Also traditional retailers are moving online in order to respond to the growing demand.

Foreign players and expansion methods

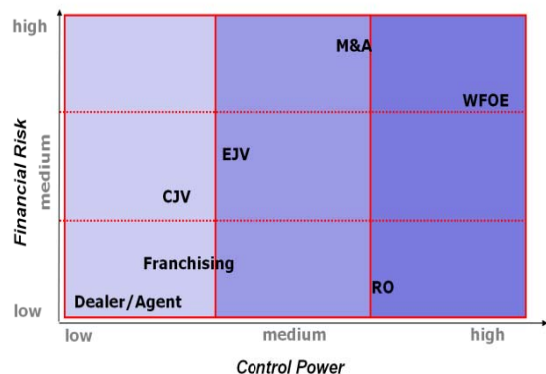
European retailers such the American Wall-Mart, the French Carrefour, the English Tesco and the German Metro AG are already present in the Chinese market for many years. Carrefour was one of the first, opening its first store in 1995.

In 2010, some foreign-funded companies achieved a growth rate of over 20% with peaks of 40% in terms of opening new stores and increasing sales in China. For example, Wall-mart opened 13 new stores and Carrefour 18, mostly in tier 2,3 or 4 cities.

In the expansion toward new regions, in tier 3 and 4 towns, the most important thing is to have good contacts and relationships with the local government. Usually, local authorities give priority to local players, rather than foreign-owned enterprises. Thus having a local partner can help a lot in obtaining all the required licenses. However, to overly rely on these intermediates figures is quite risky for foreign companies, because they don't have any direct control on the sale policies implemented by their agents. Many companies who rely on distributors don't even know who are their products' end-users, sale channels and even price. As the chart below shows, using a dealer on an agent can be cheaper, but just in the begin-

ning, since the lack of direct control can create problems in the long term, and the attempt to solve them can turn to be more expensive.

One of the main methods for expanding in the Chinese retail industry is through M&A. A successful example is Carrefour, that acquired seven supermarkets stores from Baolongcang, a regional player in Hebei. Also local players are expanding through M&A: Wumart, a Beijing leading player purchased four Lotus stores in Tianjin and Vanguard, another local chain enterprise, purchased about 2,000 stores from other regional players between 2004 and 2010.



New Social Security Law: Beijing started the implementation

After the release of the Social Insurance Law that foresees the mandatory participation of foreign employees to the Chinese national insurance system that took effect on 15th October (as we have already described in our newsletter of October), the city of Beijing released a series of circulars with the aim of implementing the law.

The latest circular was released on the 20th December by the Beijing Social Insurance Fund Management Center (BSIFMC), called “Circular on Further Improving the employment of foreigners in the city to participate in work-related social insurance issues notice”.

This circular details the deadline for the registration and the payment of the relevant backdated premiums as follows:

- the mandatory contribution accrues from the 15th October;
- the deadline for mandatory foreign employees’ social insurance registration for the month of December has been extended to the 31st December (from the 5th to 25th as per the previous circular – jingshebaofa (2011) No.55)
- a foreigner who has been employed in Beijing before the 31st October, 2011 should make a

backdated premium payment for the period from October (when the new security law has been promulgated) to December 2011;

- a foreigner who has been employed in Beijing after the 1st November 2011 should make a backdate premium payment for the period from the month in which he has been employed to the month before the month in which the foreigner made the social insurance registration;
 - a foreigner who already made the social insurance registration before the 1st January, 2012 doesn’t have to pay the late fees while is settling backdated premium payments;
 - a foreigner who made or is making the social insurance registration after the 1st January, 2012 has to pay the late fees according to the provisions contained in the “Circular on issues concerning late fee charges on employers’ overdue social insurance payment” (released on 1st August 2011).
- The provision considers also the case of foreigners whose home countries have signed bilateral or multilateral agreements with China about the avoidance of double taxation of social insurance contribution:
- if the foreigner can provide evidence of his participation in the contracting country’s social insurance system within 3 months after the ob-

taining the work permit, he doesn't have to pay premiums in the limits prescribed by the agreement; in this case if he has already made social insurance registration and premium payments, he can apply for refund;

- if the foreigner provides evidence of his participation in the contracting country's social insurance system after 3 months from the obtaining of the work permit he doesn't have to pay premiums in the limits prescribed by the agreement; if he has already made social insurance registration and

premium payments, the refund is not applicable;

- if the foreigner doesn't provide any evidence of his participation in the contracting country's social insurance system, he has to pay both premium and late fees;

- the foreigner has to pay premiums that are not included in the agreements between China and his home country or have exceeded the time limits.

Up to now, Beijing is the only town which started the implementation of the new Social Insurance Law.

In January also Tianjin and Suzhou have started the registration process of foreign workers, while Shanghai and other big towns like Guangzhou and

Shenzhen haven't done anything yet to comply with the new regulations.

The actual implementation of the new regulation is taking more time than it was foreseen, especially due to the lack of preparation and the relatively little time given to local governments for the implementation.

We will keep a constant eye on this issue and promptly inform you about any future updates.

Sostieni LINKIESTA.IT

Jesa sostiene Linkiesta.it, a cui Saro Capozzoli contribuisce, curando il blog "Bussola cinese".

Linkiesta è un giornale di qualità, indipendente e non schierato politicamente, fondato da 80 soci (professionisti, imprenditori, gente comune). Per sostenersi e crescere deve generare ricavi da pubblicità ed abbonamenti. Per il successo del giornale, crediamo inoltre nell'importanza di coinvolgere i lettori e renderli parte attiva del progetto, con idee, partecipazione e contributi.

Se vuoi dare anche un supporto concreto a **Linkiesta.it**, prima di tutto leggendolo, e poi se vuoi puoi fare una donazione spontanea.

Linkiesta.it S.p.A.

IBAN: IT50X0623009487000046412111

SWIFT: CRPPIT2P339

Istituto bancario: CARIPARMA

Causale: Donazione libera Linkiesta.it

Per maggiori informazioni:

<http://www.linkiesta.it/sostieni-linkiesta#ixzz1hK5HYw6h>

CONTRIBUTORS

Scott Sun (Supervisor)
Saro Capozzoli
Francesca Sardini

For inquires and suggestions regarding this newsletter or for any other concerns, please contact us anytime at:

francesca@jesa.com.cn

And please visit our website:

www.jesa.com.cn

Our Newsletters:

<http://www.jesa.com.cn/newsletter.html>

ADDRESS IN SHANGHAI



HOUSE 4, LANE 112, FENYANG RD.
200031 SHANGHAI - CHINA

Tel +86 21 64331555
Fax +86 21 62880072

Offices also in:
Saudi Arabia, Mongolia, Chile

LEGAL NOTICE

The content of this newsletter is composed and written by JESA, and thus it is not reproducible and cannot be diffused indiscriminately without JESA's consent. The purpose of this newsletter is to keep our contacts informed about important changes occurring in China; any use of it that differs from the initial purpose must be authorized by JESA.



Please consider the environment before
printing this document